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**Before the**
**FEDERAL COMMUNICATIONS COMMISSION**
**Washington, D.C. 20554**

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| In the Matter of | ) | |
| | ) | |
| Allocation of Costs Associated With | ) | CC Docket No. 96-112 |
| Local Exchange Carrier Provision of | ) | |
| Video Programming Services | ) | |

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**REPLY COMMENTS OF ADELPHIA COMMUNICATIONS CORPORATION**


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# SUMMARY

As the Commission properly recognized in the *Notice*, revision of the Part 64 cost allocation rules is necessary to prevent captive telephone ratepayers from financing LEC forays into video. LECs retain the ability and the incentive to cross subsidize their nonregulated services, such as video, with revenues from their regulated service offerings. Accordingly, Adelphia Communications Corporation ("Adelphia") urges the Commission promptly to revise and establish strengthened Part 64 cost allocation rules to fulfill Congress's competitive goals for open video systems and to protect competitors in the video marketplace from LEC anticompetitive harm.

The comments support the adoption of a fixed factor to allocate costs of all shared plant and the exogenous treatment of the reallocation of costs from regulated to nonregulated services. A 75 percent video/25 percent telephony fixed factor developed by Dr. Johnson for the National Cable Television Association ("NCTA") is based on stand-alone network costs and thus would be a fair, effective factor to use.

Invoking the spirit, but not the substance, of the Telecommunications Act of 1996 ("the 1996 Act"), however, LEC commenters ask the Commission to find that competition in the local exchange market is so prevalent that further LEC regulation is unnecessary. Actual conditions in the video marketplace, however, belie LECs claim to have lost their monopoly power. In fact, competition in the local exchange market is not firmly established. Alternative carriers provide exchange access or basic local exchange service to only a few customers in small, isolated pockets around the country. Nor have the market opening requirements of the 1996 Act even

been fully implemented yet. Contrary to LEC assertions, moreover, price cap regulation alone will not detect, much less prevent, LEC anticompetitive abuse of market power in shifting costs between regulated monopoly telephone services and non-regulated competitive video services.

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**REPLY COMMENTS OF ADELPHIA COMMUNICATIONS CORPORATION**

Adelphia Communications Corporation ("Adelphia") hereby submits these reply comments in response to the comments filed on the Notice of Proposed Rulemaking (the "*Notice*") issued by the Federal Communications Commission (the "Commission") in the above-referenced proceeding.

## I. INTRODUCTION.

Ignoring the specific requirements in the Telecommunications Act of 1996 ("the 1996 Act") that the Commission prevent cross subsidization, LEC commenters contend that the Commission need not adopt rules to allocate the common network costs of a shared video-telephony network because competition in the local exchange market is purportedly thriving. Alternatively, the LECs argue, the Commission should adopt general cost allocation rules that allow each LEC to choose how to allocate its shared network costs, rather than adopt "one size fits all" rules that could possibly inhibit LEC network creativity. Neither approach will satisfy the Commission's statutory mandate to protect telephone ratepayers.

The Commission must not lose sight of the purpose of the *Notice*. As the Commission properly recognized, current Part 64 cost allocation rules were not designed to allocate common costs between the nonregulated offerings, such as video, that will be introduced by incumbent

LECs and the regulated services they already offer.[1] The comments support the adoption of a fixed factor to allocate costs of all shared plant and the exogenous treatment of the reallocation of costs from regulated to nonregulated accounts. Now is the time to amend Part 64 — before extensive LEC cross subsidization occurs nationwide.

## II. THE RECENTLY RELEASED *OVS ORDER* UNDERSCORES THE NEED FOR THE COMMISSION PROMPTLY TO ADOPT STRENGTHENED PART 64 COST ALLOCATION RULES.

As an initial matter, and since comments were filed in response to the *Notice*, the Commission has released its *OVS Order* which sets forth a streamlined process for LEC OVS authorization.[2] Promptly establishing strengthened cost allocation rules will be critical to prevent rampant anticompetitive abuses in the streamlined process for LEC open video system ("OVS") authorization delineated in the *OVS Order*. Absent expeditious adoption of fortified cost allocation methodologies calculated to identify anticompetitive cost-shifting in LEC joint offerings of telephony and open video systems, the 10-day certification process would hinder rather than promote nondiscriminatory access to and competitive delivery of the OVS platform as envisioned by Congress in enacting Section 653 of the 1996 Act. 47 U.S.C. § 653.

The purpose of the new FCC Form 1275 adopted in the *OVS Order* is to verify that a LEC has complied with the various OVS carriage and nondiscrimination rules implemented

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1/ *Notice* at ¶ 2.

2/ *See Implementation of Section 302 of the Telecommunications Act of 1996*, Second Report and Order, CS Docket No. 96-46, FCC 96-249, at ¶¶ 27-36 (released June 3, 1996) ("*OVS Order*").

by the *OVS Order* pursuant to Section 653(b) of the Telecommunications Act.[3] Because the FCC Form 1275 certification process is streamlined, LECs may obtain certification within 10 days of filing and need only modify their cost allocation manuals on a *post-hoc* basis. Moreover, competitors are given only five days from the day that a LEC certification request is filed in which to submit oppositions or comments.[4]

To help detect anticompetitive abuse in LEC OVS offerings, the Commission must at a minimum impose tougher Part 64 cost allocation standards as a competitive backstop. Particularly, given the quickened schedule contemplated by the streamlined certification process adopted in the *OVS Order*, moreover, time is of the essence in putting in place sufficient prophylactic cost allocation measures to guard against LEC anticompetitive cross-subsidization of OVS and telephony offerings.

Cost allocation rules must be adopted expeditiously in this docket to give weight to the FCC Form 1275 public interest review process. Failing this, the streamlined LEC OVS entry policies adopted in the *OVS Order* will not come close to producing the social and economic benefits for the video marketplace envisioned by the Commission.

## III. ALL NON-LEC COMMENTERS AGREE THAT ADOPTION OF A FIXED FACTOR TO ALLOCATE COSTS OF ALL SHARED PLANT IS APPROPRIATE.

Turning to a review of the comments filed in response to the *Notice* in this proceeding, all non-LEC commenters, including state utility commissions, that filed in this proceeding

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3/ *See OVS Order*, at ¶¶ 27-36; new 47 C.F.R. § 76.1502, *reprinted in OVS Order*, at Appendix B.

4/ *See id.*

support the use of a fixed factor to allocate common costs.[5] The LECs, in contrast, oppose the use of a fixed factor, arguing that the adoption of a fixed factor will restrict LEC ability to vary network architecture.[6] Alternatively, the LECs propose to adopt a "fixed" factor that allocates common costs according to the relative number of video and telephony customers[7] or propose to allocate common costs to reflect the video services currently offered, such that a system offering only basic cable would not be allocated the same costs as a system that offers basic cable, video-on-demand and interactive video.[8] Both of these proposals, the LECs claim, are cost-causative and therefore proper.

Both proposals would allocate substantially more cost to telephone customers than to video customers, even though the expense has been incurred to offer video services. The LECs fail to explain, however, how these proposals are cost-causative, their assertions notwithstanding. Even though LEC video offerings are expanding, commenters fail to explain how it is cost-causative for telephone ratepayers to pay for virtually all of the shared network costs in the early years of video operation, or how it is cost-causative for the portion of shared network costs allocated to telephone ratepayers, assuming a video operation is successful, to

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5/ *See, e.g.,* Pennsylvania Office of Consumer Advocate Comments at 12; Alabama Public Service Commission Comments at 5; State of New York Department of Public Service Comments at 2; Florida Public Service Commission Comments at 2.

6/ *See, e.g.,* Southwestern Bell Comments at 13; U S West Comments at 6; United States Telephone Association ("USTA") Comments at 8.

7/ *See* U S West Comments at 11; NYNEX Comments at 13; Southwestern Bell Comments at 9.

8/ Southwestern Bell Comments at 14.

decrease over time. These purportedly "cost-causative" LEC proposals are simply arbitrary methods of allocating costs that will always disadvantage LEC telephone customers.

Adoption of a fixed allocation factor, as many parties noted, is the best available method of allocating shared network costs. The Commission should adopt a fixed factor that reflects the relative network costs of video and telephony such as the 75 percent/25 percent factor developed by Dr. Johnson for NCTA[9/] and apply it to all LECs providing or preparing to provide video and telephony using a shared network. Additionally, a cost ceiling, such as the stand-alone costs of telephony, should be used in conjunction with a fixed factor allocation to ensure that telephone ratepayers never pay more for telephone service than they would if a LEC had a telephony-only network.[10/]

When a fixed factor is adopted it must apply to all shared plant, not just new investment.[11/] That few LECs are providing video service now, and thus few networks are currently shared, is irrelevant.[12/] Telephone ratepayers are paying for network rebuilds all across the country, purportedly to support "state-of-the-art" telephone networks, and as USTA observes,

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9/ National Cable Television Association ("NCTA") Comments, Attachment 1. *See also* Comcast and Adelphia Comments at 8 (fixed factor should allocate at least 70 percent of common costs to nonregulated services); California Cable Television Association Comments at 17-20 (fixed factor should allocate 76 percent of common costs to nonregulated services); Time Wagner Cable Comments at 10-11 (fixed factor should allocate at least 75 percent of common costs to nonregulated services); Cox Comments at 8-10 (fixed factor should allocate 75 percent of common costs to nonregulated services).

10/ *See* NCTA Comments at 19; California Cable Television Association Comments at 14-16; Pennsylvania Office of Consumer Advocate Comments at 11-12.

11/ *See, e.g.,* GTE Comments at 7 n.6.

12/ *See, e.g.,* Bell Atlantic Comments at 4.

when LECs rebuild plant they do so in a manner to include capacity beyond current needs.[13/] It follows logically, therefore, that any LEC use of shared plant was anticipated and planned for by the LEC, regardless of when the LEC made its public announcement that it was "going into video." Thus, any regulatory regime that allows the LECs to foist these video costs onto ratepayers until the LECs announce shared network video plans to the public is unjustified and inconsistent with the requirements of the 1996 Act.

Further, to prevent ratepayers from currently paying for spare fiber capacity that may ultimately be used for unregulated services, the Commission should establish a presumption that spare facilities will be used for unregulated services and allocate their costs accordingly.[14/] The parties with full information, the LECs, can then rebut the presumption and have costs allocated to regulated services by conclusively showing that the facilities will be used to meet projected and actual telephony needs.

## IV. ALL NON-LEC COMMENTERS ALSO AGREE THAT REALLOCATED INVESTMENT SHOULD BE TREATED AS EXOGENOUS COST CHANGES.

Non-LEC commenters also agree that cost changes caused by the reallocation of investment from regulated to nonregulated activities pursuant to the Part 64 cost allocation rules must be considered exogenous cost changes.[15/] As many commenters observed, any failure to adjust a LEC's price cap indices to reflect a reallocation of the costs of facilities paid for by

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13/ USTA Comments at 20.

14/ NCTA Comments at 22.

15/ *Notice* at ¶ 60; *see, e.g.*, Pennsylvania Office of Consumer Advocate Comments at 16-17; Alabama Public Service Commission Comments at 7-8; AT&T Comments at 10-11; MCI Comments at 16-17.

captive customers of regulated services to nonregulated services would be tantamount to a direct cross subsidy of a LEC's entry into the video market.[16] Because cross subsidy from regulated services is forbidden by the 1996 Act, failure to treat the reallocation of regulated facilities as an exogenous cost change would be contrary to law.[17]

The LECs, however, argue that exogenous cost treatment is not proper because the productivity offset in the LEC price cap adjustment formula already captures economies of scale and scope, including economies of scale and scope resulting from the offering of new nonregulated services.[18] Thus, the LECs claim, exogenous cost treatment of a reallocation would reduce LEC price cap indices twice in a "double reduction," once through the productivity offset and once through exogenous cost treatment. This LEC argument that the productivity factor captures all economies of a nonregulated service might be credible for nonregulated services that represent a tiny portion of overall LEC investment and that augment traditional telephony offerings such as Caller ID. It is not credible however, where an entire new network is being designed. Furthermore, adoption of this policy would result in ratepayers funding entire network rebuilds and receiving only a tiny fraction of the benefits from the new services

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16/ Alabama Public Service Commission Comments at 7; Pennsylvania Office of Consumer Advocate Comments at 16; Comcast and Adelphia Comments at 8.

17/ *See* 47 U.S.C. § 254(k). ("SUBSIDY OF COMPETITIVE SERVICES PROHIBITED — A telecommunications carrier may not use services that are not competitive to subsidize services that are subject to competition. The Commission . . . shall establish any necessary cost allocation rules, accounting safeguards, and guidelines to ensure that services included in the definition of universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide those services.")

18/ BellSouth Comments at 10-11.

provided. The price cap formula was designed to capture economies of scale and scope of telephone, not video services.

## V. PRICE CAPS DO NOT PREVENT LEC CROSS SUBSIDIZATION.

The LECs claim that revised cost allocation rules are unnecessary to prevent cross subsidization because the current price cap regime removes LEC incentives to cross subsidize. They argue that the price cap regime constrains the LECs from increasing regulated prices even if network costs rise,[19/] and claim that for those LECs that have elected the no sharing option, "cost allocation requirements are irrelevant."[20/] These arguments ignore reality; there is no "pure" price cap regime where LEC costs are divorced from LEC prices. Furthermore, price cap regulation alone does not detect, much less prevent, LEC anticompetitive abuse of market power in shifting costs between regulated monopoly telephone services and non-regulated competitive video services.

As several commenters demonstrated, even if a LEC elects the price cap no-sharing option in one year, it still has the incentive to misallocate systematically costs to regulated services to reduce regulated earnings if it adopts a different sharing option in following years to avoid future sharing obligations.[21/] If a LEC can elect on an annual basis to change which price cap option it uses, and if LEC costs are reviewed for any reason, including for universal service, the efficacy of a "pure" price cap regime in preventing cross subsidy is vitiated. Further, federal

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19/ *See, e.g.,* USTA Comments at 4-6; Pacific Bell Comments at 3-6; BellSouth Comments at 4-5; Bell Atlantic Comments at 1-3.

20/ *See, e.g.,* Pacific Bell Comments at 3.

21/ *See, e.g.,* Comcast and Adelphia Comments at 9; Cox Comments at 11; *see also* AT&T Comments at 11.

price cap rules apply only to the 25 percent *interstate* portion of local loop costs. Consequently, even if all LECs were operating under a "pure" price cap regime at the federal level, LECs would still have an incentive to misallocate costs unless each state also had an exactly matched intrastate "pure" price cap regime.[22/]

Because the price cap regime standing alone is ineffective in identifying LEC anticompetitive cost-shifting and does not constrain LEC ability and incentives to cross subsidize, LEC requests that the Commission forbear from continuing to apply Part 64 rules to price cap LECs should be summarily dismissed.[23/] Instead, the Commission should, as the *Notice* suggests, revise the Part 64 rules to accommodate LEC use of the same network facilities to provide video programming service and other competitive offerings not subject to Title II.[24/] Similarly, other LEC calls for the Commission to loosen current rules, such as the Bell Atlantic proposal to update cost allocation manuals annually instead of quarterly and the Ameritech proposal to change the independent audit requirement from annual to bi-annual, should also be rejected.[25/]

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22/ Additionally, there is a large number of independent LECs that still elect rate-of-return rather than price cap regulation. Accurate cost allocation rules are especially vital for these carriers to prevent universal service funds from subsidizing nonregulated ventures.

23/ *See, e.g.,* BellSouth Comments at 9-10; NYNEX Comments at 5-6; Ameritech Comments at 4-10. *See* Bell Atlantic Comments, Exhibit B.

24/ *Notice* at ¶ 2.

25/ *See* Bell Atlantic Comments, Exhibit B; Ameritech Comments at 14-15.

The LECs urge the Commission to adopt minimal common cost rules because of the "significant competition" currently faced by the LECs in their territories.[26] The LECs would have the Commission believe that competition in the local exchange market is thriving and that, as the LECs have lost their monopoly status, competition, not regulation, will be sufficient to protect consumers from cross subsidization. Competition and deregulation do go hand-in-hand, but despite LEC portrayals to the contrary, competition in the local exchange market is not yet here. Congress has set a national course towards telephone competition that the Commission is committed to implement, but until competition *actually exists*, the Commission has an obligation to protect ratepayers from cross-subsidization.

## VI. CONCLUSION

Accordingly, Adelphia urges the Commission to act now to adopt toughened Part 64 cost allocation rules that are vital to fulfilling Congress's and the Commission's envisioned competitive framework for the video marketplace. Adopting a fixed cost allocation factor and exogenous treatment of LEC OVS-related cost changes are just a few examples of the type of cost oversight that will be necessary to help detect and prevent LEC leveraging of telephone market power into the open video systems market.

Absent the Commission's global adoption of strengthened Part 64 cost allocation rules, the streamlined framework for LEC OVS authorization will only encumber and impair rather than enhance competition in the video marketplace. This result would be contrary to, and would wholly eviscerate, Congress's pro-competitive intent in enacting the open video systems framework in Section 653 of the 1996 Act.

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26/ USTA Comments at 10-11.

Furthermore, LEC claims that existing price cap mechanisms will suffice to ensure the competitive deployment of OVS are totally without merit. It is well-documented that the existing price cap scheme does nothing to detect, let alone prevent, LEC anticompetitive abuse of market power in the joint offering of regulated telephony services and non-regulated competitive video services. Preserving the *status quo* in light of the Commission's recent action further to streamline the certification process for LEC OVS authority in the *OVS Order* will only make a bad situation much worse.

Now is the time and this is the docket where the Commission must decide the pivotal issues that will give meaning and scope to the framework for open video services that will fulfill its competitive vision. Solidifying Part 64 cost allocation mechanisms to assist the Commission and LEC competitors in reviewing and identifying potential anticompetitive abuses in LEC video service offerings is the first and most important step the Commission can take toward realizing that vision.

Respectfully submitted,

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June 12, 1996

## CERTIFICATE OF SERVICE

I, **Jeanette M. Corley**, a secretary at the law firm of Dow, Lohnes & Albertson, hereby certify that on this 12th day of June, 1996, a copy of the **Reply Comments of Adelphia Communications Corporation** was sent via hand delivery to the following:

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